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No. 87-2111

In the Supreme Court of the United States

OCTOBER TERM, 1988

EASTER HOUSE, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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Petitioner contends that the courts below erred in finding that it did not satisfy the statutory qualifications for tax exemption under Section 501(c)(3) of the Internal Revenue Code.[1]

1. Petitioner is an organization that, by means of extensive advertising, locates women with unwanted pregnancies and places their babies with adoptive parents. Petitioner charges the adoptive parents a fixed fee for this service that has been set at a sufficiently high figure ($16,500, of which $1,500 was nonrefundable, in 1985) to more than cover the costs associated with the adoptions. If a pregnant woman contacts petitioner, she is given an ini-

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[1] Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended (the Code).

tial consultation with a social worker to discuss her options. If the woman decides to place her child with petitioner for adoption and has a financial need, petitioner provides comprehensive services—including housing, financial assistance for food, clothing, and medical services, and counseling. If the woman does not decide to place her child with petitioner for adoption, she receives no assistance beyond the initial counseling session. Pet. App. 10a-16a. Qualified parents who are unable to afford the $16,500 are unable to adopt a child through petitioner, except to the extent that they are able to afford a "problem placement" (*i.e.*, a child who is difficult to place because of age, poor health, race, or some other characteristic), for which petitioner charges a reduced fee. Petitioner's income derives entirely from the fees charged to adoptive parents; it does not solicit contributions, it does not seek or receive funding from any governmental source, and it does not use any volunteers to assist its paid staff of 15-20 persons. *Id.* at 16a-20a, 71a.

Seymour Kurtz is petitioner's president and its sole "life member," which gives him the power to appoint all of the other directors. Under petitioner's bylaws, these positions vested sweeping power in Kurtz, including the power to decide what corporate affairs will be managed by the life member alone. At all relevant times, Kurtz was also involved, either as the sole owner or as a director, with three other organizations engaged in adoption-related activities. Petitioner engaged in financial transactions with each of these three entities, including an $86,681 loan to one of the organizations, which was uncollectible because the debtor became inactive and without assets. Pet. App. 20a-24a.

2. Petitioner operated as a for-profit corporation beginning in 1960. In 1983, it amended its articles of incorporation to become a non-profit corporation, and it ap-

plied for tax-exempt status under Section 501(c)(3) of the Code. C.A. App. 771. The Commissioner denied petitioner's application, stating that petitioner operated in a manner not "distinguishable from a commercial adoption agency." He concluded that a substantial purpose of petitioner's activity was commercial and hence that petitioner was not operated exclusively for tax-exempt purposes, as required by Section 501(c)(3). The Commissioner also found that petitioner had not shown that no part of its net earnings inured to the benefit of a private individual. Pet. App. 25a-26a.

Petitioner sought review of the Commissioner's determination in the Claims Court, pursuant to Section 7428 of the Code. The Claims Court sustained the Commissioner's position (Pet. App. 8a-72a). The court held that petitioner was operated for the substantial commercial purpose of earning profits from placing children for adoption (*id.* at 44a-49a, 67a-71a). The court also agreed that petitioner had failed to show that no part of its net earnings inured to the benefit of a private individual (*id.* at 49a-59a). Indeed, pointing to Kurtz's use of petitioner as a "private source of loan credit" (*id.* at 57a-59a) and to what the court found to be excessive compensation (*id.* at 56a-57a), the Claims Court concluded that part of petitioner's net earnings "clearly inured to the benefit of Kurtz" (*id.* at 56a). The court of appeals affirmed, agreeing with the Claims Court that petitioner failed to qualify as a tax-exempt organization both because it was not operated primarily for charitable purposes and because a substantial part of its net earnings inured to Kurtz (*id.* at 1a-4aa).

3. a. It is well established that the question whether an organization has a non-exempt purpose that is sufficiently substantial to make it ineligible for a Section 501(c)(3) tax exemption, rather than one that is merely incidental to its operations, is a question of fact. See, *e.g.*, *Church By*

Mail, Inc. v. *Commissioner*, 765 F.2d 1387, 1390 (9th Cir. 1985); *Federation Pharmacy Services, Inc.* v. *Commissioner*, 625 F.2d 804, 806 (8th Cir. 1980). Whether any part of an organization's net earnings inures to private persons is also a question of fact. See, *e.g.*, *Bubbling Well Church of Universal Love, Inc.* v. *Commissioner*, 670 F.2d 104 (9th Cir. 1981). The factual conclusions of both courts below that petitioner failed to qualify for a Section 501(c)(3) tax exemption on both of these grounds were amply supported by the record. In particular, petitioner charged adoptive parents high fees that yielded substantial profits. In 1983, petitioner made a profit of more than $257,000 (a 25% margin), and it also generated large reserve accumulations. See Pet. App. 20a, 45a. This fact, coupled with the fact that, as a general rule, petitioner's services were reserved exclusively for women who decided to place their children with petitioner for adoption and for adoptive parents who could afford to pay the fixed fees, strongly supported the finding that petitioner's purpose was largely commercial, not charitable. By the same token, the inurement finding was supported by Kurtz's use of petitioner as a source of credit for other entities that he controlled.

b. Petitioner does not seriously dispute that the conclusion of the courts below that it does not qualify for a tax exemption was amply supported by the factual findings. Rather, petitioner argues (Pet. 6-17) that the findings made by the Claims Court and relied upon by the court of appeals are not faithful to the administrative record. This factbound contention is without merit.

Petitioner correctly states (Pet. 8) that, under Rule 217 of the Tax Court's Rules of Practice and Procedure, the facts contained in the administrative record must be assumed to be true in a judicial proceeding commenced under Section 7428 of the Code. But that rule was not violated here. As the Claims Court observed (Pet. App.

49a), petitioner's contention in this regard "fails to distinguish the difference between its arguments and facts." The courts were not required to accept petitioner's arguments as uncontrovertible; for example, petitioner's conclusory assertions that all of its activities "are essential to accomplish its exempt charitable purposes" (Pet. 14) or that its fees "are solely established to cover [its] costs" (Pet. 12) are not binding on the courts simply because they were stated by petitioner in the administrative record.[2] The courts were entitled to draw their own conclusions from the facts contained in the administrative record, and that is what they did.[3] Accordingly, the courts in no way

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[2] The statements upon which petitioner relies are contained in a "Statement of Protest to Proposed Adverse Ruling" that was submitted by Kurtz in his capacity as petitioner's president. See C.A. App. 782-821.

[3] In arguing that "the lower courts failed to give effect to the administrative record" (Pet. 11), petitioner selects certain portions of the record that arguably support its contentions, but ignores those facts contained in the record that were relied upon by the courts below. Petitioner thus fails to demonstrate that the conclusions drawn by the courts below from the record as a whole were erroneous. For example, petitioner disputes the assertion that it accumulated substantial profits by emphasizing that its balance sheet showed liquid assets of only $99,981 at the end of 1983. See Pet. 11-13. This figure, however, does not take into account the fact that petitioner had made loans to other Kurtz-controlled entities that totaled more than $160,000 by the end of 1983 (C.A. App. 406, 441), and at least $277,000 by the end of 1984 (*id.* at 379). Petitioner also asserts (Pet. 15) that the record shows that "[p]etitioner always pays the expenses of mothers who decide not to place their children for adoption." The record citation, however, merely gives instances of pregnant women who had agreed to place their children with petitioner for adoption, and therefore had had some expenses paid for them, but subsequently changed their minds (see C.A. App. 582, 599-602). The Claims Court recognized this fact, along with the fact that petitioner generally did not cover the medical expenses of such women after they had changed their minds (see Pet. App. 14a; C.A. App. 440).

violated Tax Court Rule 217, and the decisions below are fully consistent with the court of appeals decisions cited by petitioner that apply that rule. See Pet. 6-7.[4]

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

CHARLES FRIED
Solicitor General

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[4] There is no substance to petitioner's assertion (Pet. 17-19) that its due process rights were violated because the government appended to its appellate brief a copy of an article published in the National Law Journal. This article, which indicated that many adoption agencies are operated on a commercial basis for profit-making purposes, was submitted by the government only in response to petitioner's submission of extra-record material, such as newspaper articles, to support its contention that an adoption agency's activities are charitable per se. The government's brief stated that the National Law Journal article should be considered to rebut petitioner's assertions "only in the event the Court should disagree with our view of the propriety of such [extra-record] submissions in an appellate brief" (Gov't C.A. Br. 40 n.40).

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